Low-End Consumers Getting Squeezed.

It's not just the stock market that's bifurcated -- it's consumers too. High-end consumers' spending power is keeping prices high, putting a squeeze low-end consumers. Companies feel this -- from restaurants to retailers to jewelers. Indeed, the Fed's dovish tone is boosting stocks, and in turn, high-end consumers spending power.

Watch unemployment. It's a guide to S&P earnings. If the jobless rate keeps rising, it means S&P earnings are declining.

And watch China. Beijing may be teasing a RMB devaluation that would have big Global implications. Other EMs have already kicked off a Global easing cycle. Remember they started the Global tightening cycle back in 2021.

Finally check out my travel notes from the great trip to HK & Australia that Will set up.

Take a look at the Narrative below, and let us know if you have any questions, suggestions, or criticisms.

7 Takeaways From Nancy's Narrative:

1. **It's The Best Of Times For High-End Consumers -- Not For Low-End.**
2. **Watching GDI & Corporate Revenues Stall…**
3. **Is China Foreshadowing A Devaluation? BIG News, If True.**
4. **Watch Swings In Unemployment.**
5. **Here Comes The Global Easing Cycle.**
6. **Trip Notes: From Hong Kong To Australia.**
7. **Watching AI Closely.**

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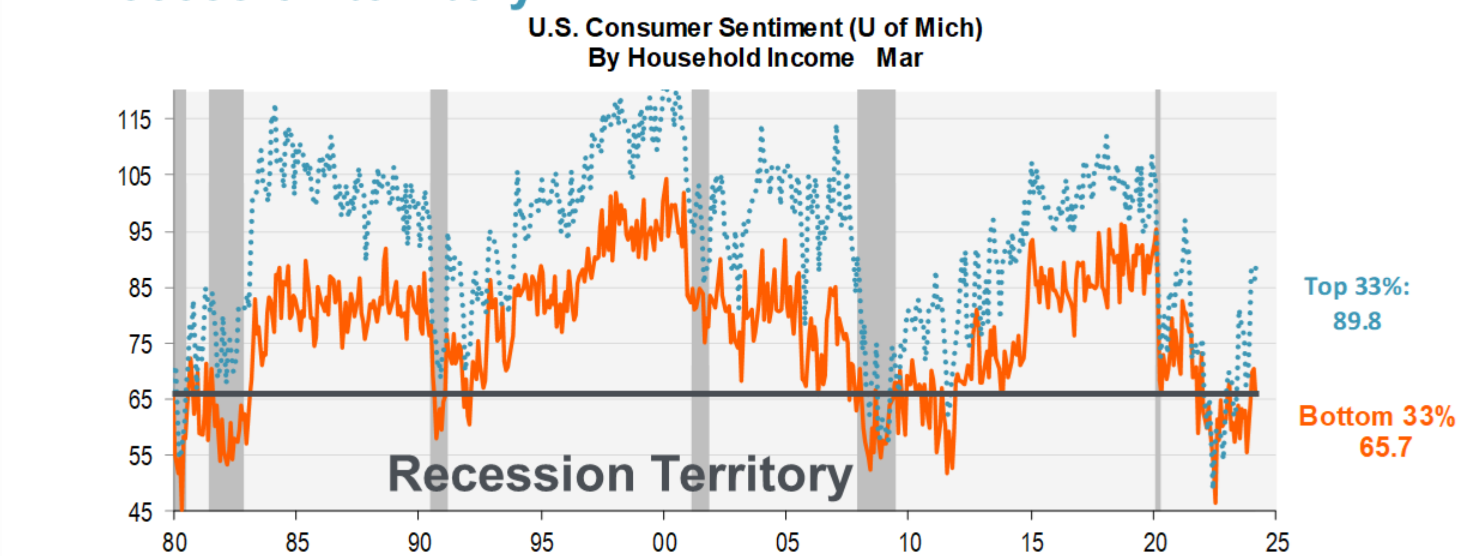
Nancy's Weekly Narrative

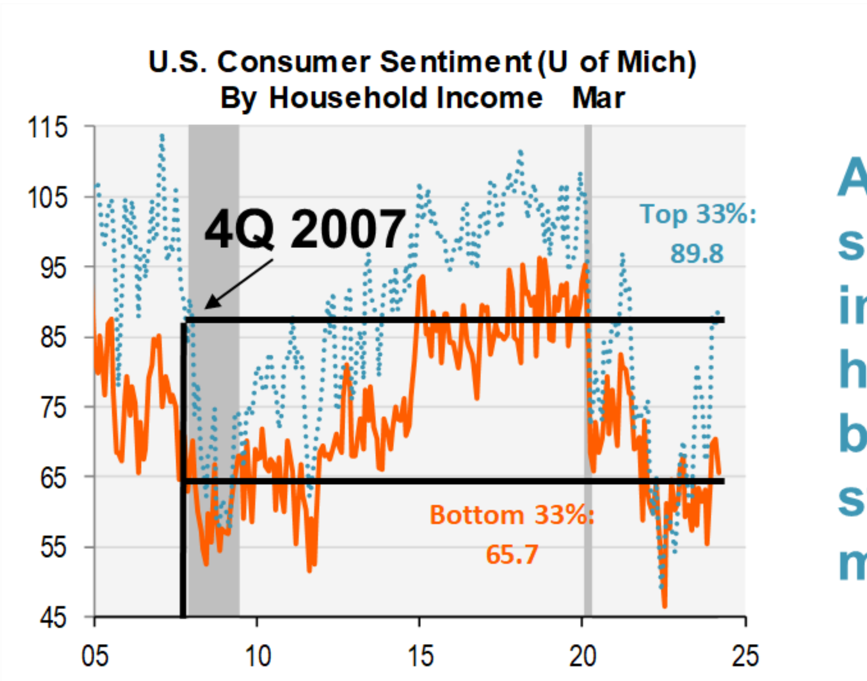
It's The Best Of Times For High-End Consumers -- Not For Low-End.

The U of Mich consumer confidence survey for early March had quite the dichotomy … low-end consumer confidence moved deeper in recession territory, while high-end confidence hit a cycle high.

High-end consumers loving life … with a stock market wealth effect, and cash to spend. No such luck on the low end … low-end consumer confidence is in recession territory.



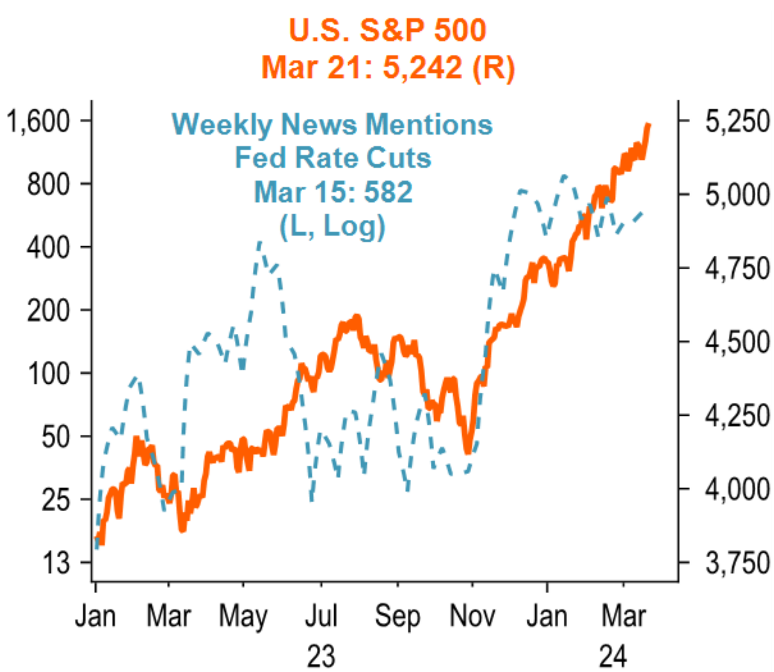
When did we last see this pattern? 4Q 2007.



Ahh. There was a similar discrepancy in 4Q of 2007, with high-end consumers benefiting from the still strong stock market.

Why the divergence? For the top tier…

1. **Fed rate cut talk is powering stocks, and in turn, high-end consumer confidence & spending.**



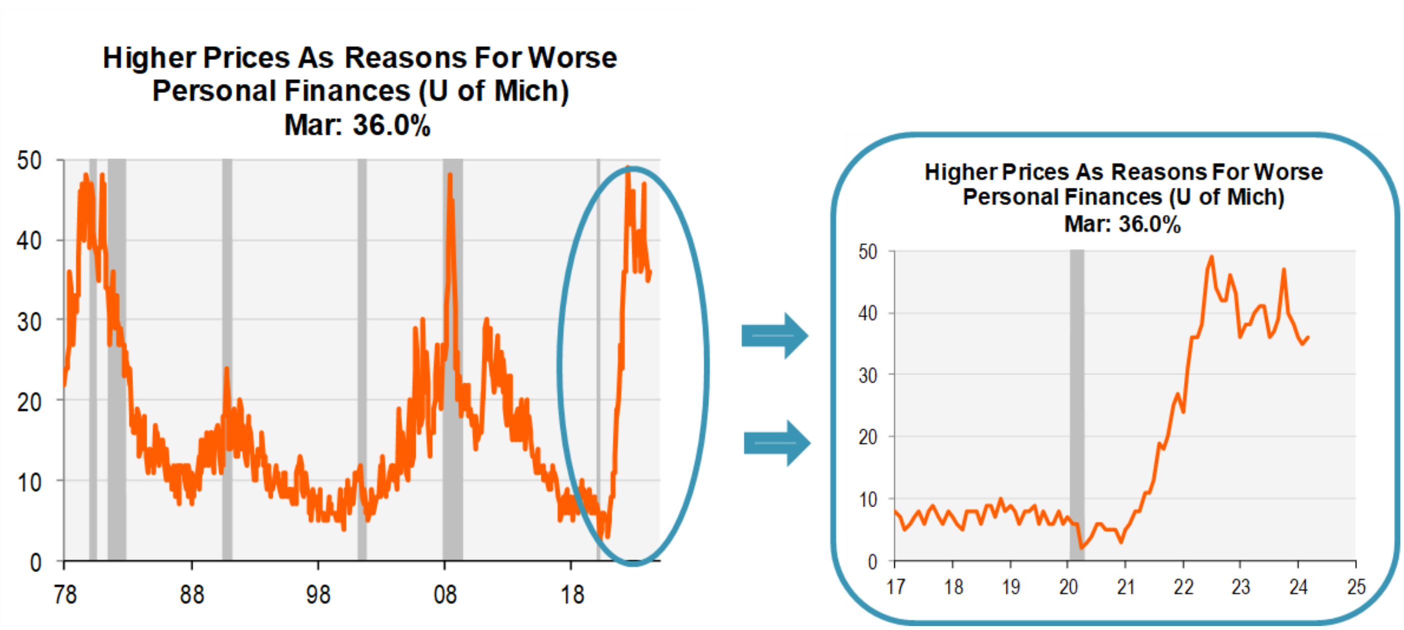
Fed rate cut mentions (blue dots) have helped boost the stock market (orange line).

2. **High-end consumers still have excess savings, supporting consumer spending. Looks like as long as stocks rally, they'll keep spending.**
3. **House prices are still near record highs – another wealth effect support for spending.**

But low-end consumers live in a different world, explaining their recession-like sentiment.

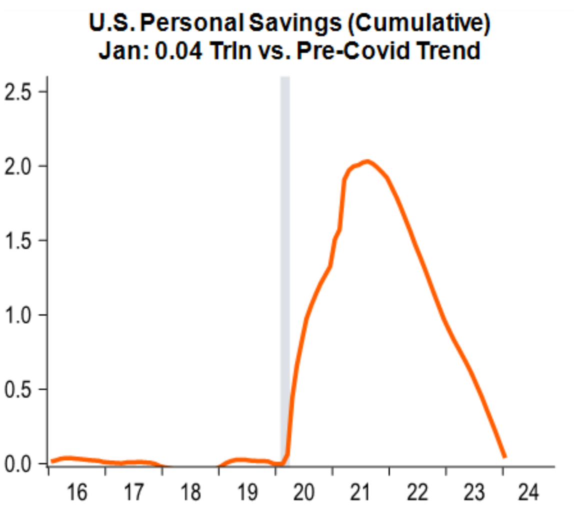
1. Facing tight budgets, low-end real purchasing power is being smothered by sticky inflation and high prices. See right-hand chart below.

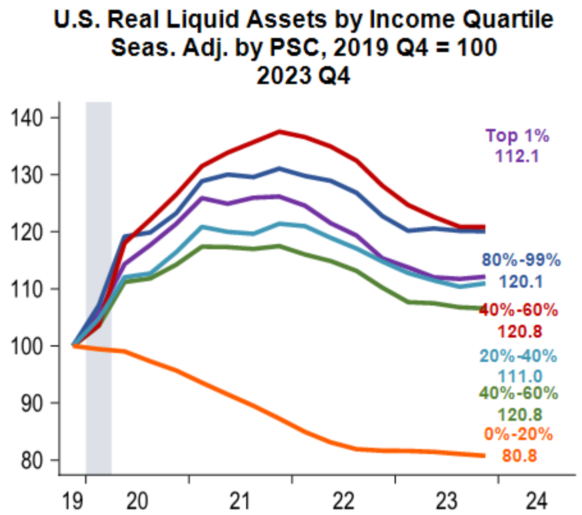
It's different this time: Although inflation has clearly slowed, consumers still believe that prices are still too high, helping explain why low-end consumer confidence is so depressed.



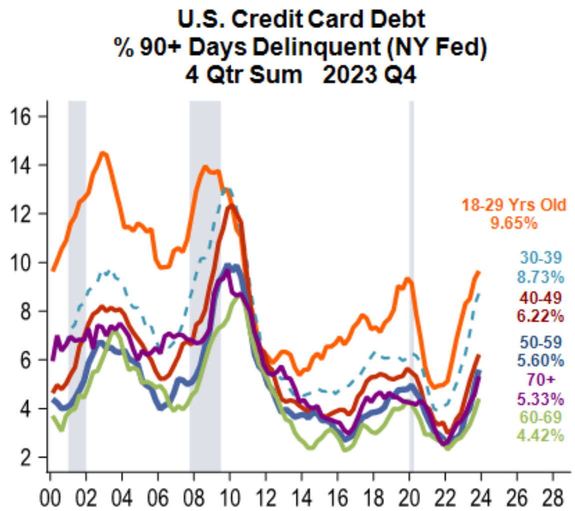
2. Low-end consumers are facing sticky & high prices with exhausted savings. (Orange line, right-hand chart below.) Bad news for Kohl's, Darden, Dollar Tree, Dollar General, McDonald's, etc.

Total real excess savings are nearly gone, and at the low end, they're way below pre-Covid.





3. The combination of high prices and no savings cushion is driving low-end consumers to use credit cards to support spending. And delinquency rates have hooked up, particularly for younger folks (chart below). Synchrony, Capital One, and Discover all reported higher delinquency rates.



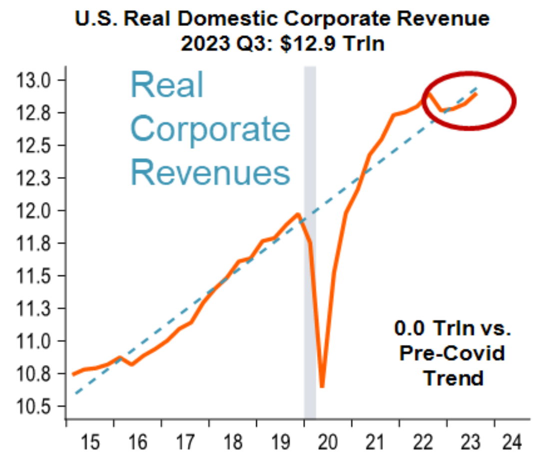
Credit card delinquency rates ARE increasing, a sign of deteriorating economic activity.

All that said, the S&P 500 is on track to post a 10% gain in 1Q – and there's never been a recession right after a quarter with such a rally -- good news for high-end consumers. But the widening spending power disparity highlights an increasingly fragmented economic backdrop. Stay tuned.

Watching GDI & Corporate Revenues Stall…

On Thursday, we'll finally get 4Q real GDI and corporate revenues, when the Bureau of Economic Analysis issues its 3rd GDP report for the quarter. Though a bit late, these two stats are very important. We think GDI gives a cleaner eco read, because it's much easier to measure than GDP. Why? Everyone reports revenues (GDI) to the IRS, while the govt struggles to measure output (GDP) for small & medium-size companies (that are struggling, as the NFIB data show). Similarly, we'll get real corporate revenues for the whole range of enterprises. And as of the last reports – 3Q 2023 -- both real GDI and real corporate revenues have been basically stagnant for a while -- reflecting the lagged impact of higher rates and tighter lending standards.

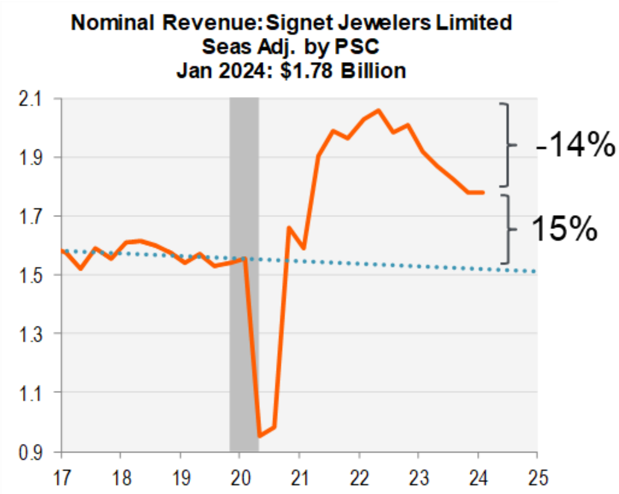
Real GDI and real corporate revenues are stagnant. We'll see 4Q readings on Thursday.



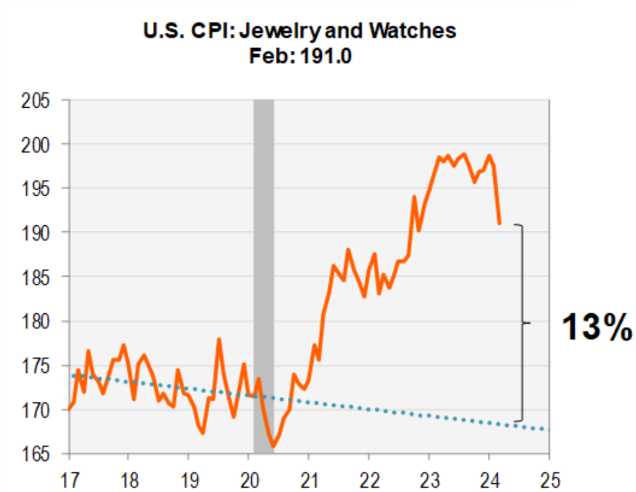
As is true with consumers, among companies there continue to be winners -- those with solid earnings/EPS. Last week, FedEx & Winnebago surprised on the upside -- and Micron soared. But in keeping with the consumer health divergence detailed above, there was notable weakness in lower-end consumer-oriented companies. See below. And in just a month, we'll be looking at 1Q earnings/revenues. Time flies.

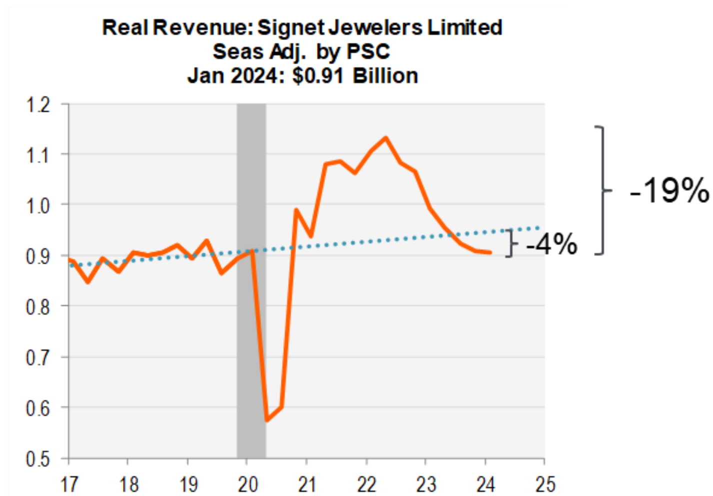
1. Olive Garden owner Darden Restaurants fell 6.5% after its revenue forecast for the full fiscal year came up shy of analysts' expectations. NYT 3/22
2. Darden is seeing lower-income consumers pull back. BBG 3/21
3. Nike shares tumbled 7% on Friday after it warned of lower sales in its first half as it replaces older styles with trendier sneakers. NY Post 3/23
4. Lululemon's gloomy forecast spotlights the challenges for retailers as customers reduce discretionary spending due to sticky inflation. NY Post 3/23. The CEO expressed caution about consumer demand and said the company has been navigating a slower start to the year. WSJ 3/23

5. Zales owner says couples may delay engagements due to the economy. Signet 3/20



The Covid-related jewelry bubble is bursting, with nominal sales declining, although still elevated by the surge in prices, with real sales now below their pre-Covid trend.





6. Chewy's near-term sales guidance came in below expectations amid a wider pet industry slowdown. BBG 3/21

7. Fabric and crafts retailer Joann filed for bankruptcy, unable to sustain its debt load after a sales boom after the pandemic lockdowns faded. BBG 3/18

8. Ted Baker is on the brink of collapse as its US owner prepares to place it into administration, putting hundreds of jobs at risk. Telegraph 3/18

9. Presto has laid off 18% of its workforce, or 24 corporate staff members, as it winds down its tablet business. Industry Dive 3/19

10. Univilever plans to separate its ice cream business and cut 7,500 jobs as the CEO seeks to boost profits and jump start sluggish growth. BBG 3/19

11. Five Below shares drop as much as 13%, after the discount retailer's full-year net sales guidance failed to meet consensus expectations. BBG 3/21

12. Academy Sports & Outdoors falls as the retailer forecast a decline in 2025 fiscal year comparable sales and missed net sales estimates. BBG 3/21

13. Chrysler-parent Stellantis is laying off about 400 employees in the U.S., mostly in its software and engineering divisions, the latest in a string of cutbacks by the automaker. WSJ 3/23

14. JetBlue said it will stop flying to 5 "unprofitable" markets. BBG 3/19Deloitte has launched the biggest overhaul of its global operations in a decade as the Big Four firm seeks to cut costs and reduce its complexity in the face of an expected market slowdown. FT 3/19

15. Accenture was a weight on the market after dropping 9.3% The consulting and professional services company reported stronger profit for the latest quarter than analysts expected. But its forecast for profit over this full fiscal year fell short of estimates. NYT 3/22

16. Fulfillment and last-mile delivery provider Point Pickup Technologies has ceased operations and is seeking a sale. SupplyChain Dive 3/20

17. An Illinois trucking company with 183 trucks and 171 drivers recently filed for Chapter 111 bankruptcy protection. FreightWaves 3/214

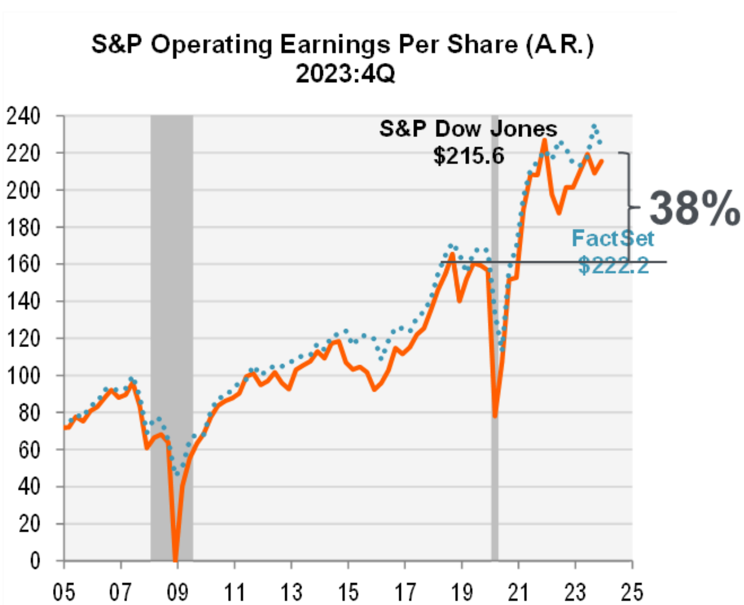
18. Barclay's is preparing to cut several hundred jobs within its investment bank division as the firm embarks on a years-long effort to trim costs and boost profits. BBG 3/20

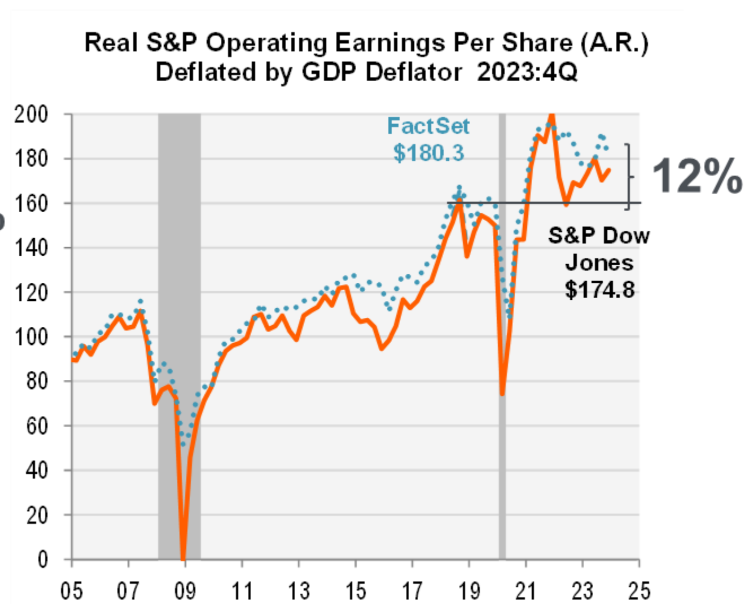
19. Herbalife intends to implement actions throughout 2024 to streamline its employee structure under an internal restructuring plan. BGG 3/20

20. Bankrupt Petersen Health Care, one of the nation's largest nursing home operators, said Friday it intends to sell its assets in Chapter 11. BBG 3/22

Well, on to 1Q earnings season. And before we can forecast, we're reminded of a basic lesson Greenspan taught us: Before you can forecast, you have to know where you are. And right now, broad earnings are high – but they're stagnant and bloated by inflation … see the charts below.

Yes, nominal S&P earnings are way above their pre-Covid level, but they've been basically flat for 2 years. And adjusted for inflation, they're just 12% higher than pre-Covid, notably off their peak.





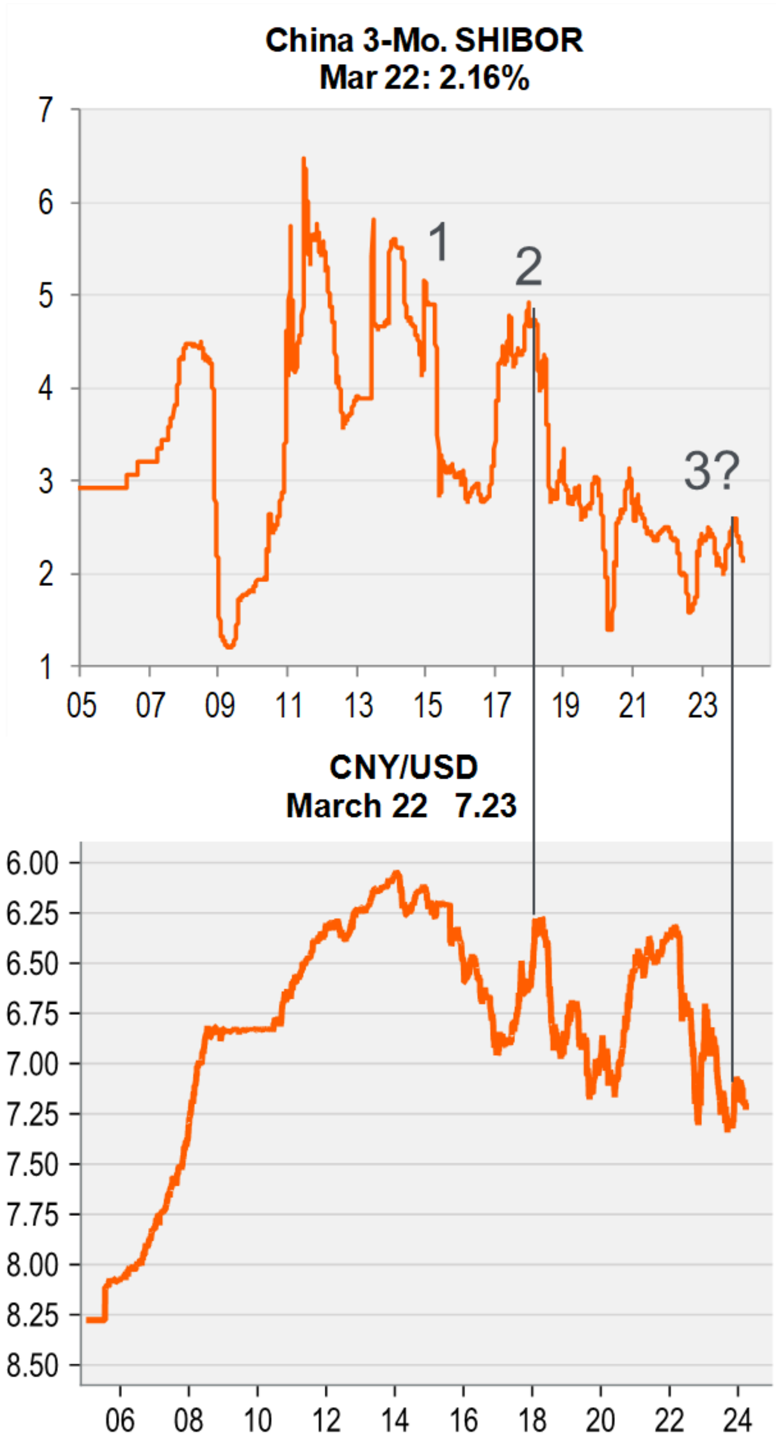
At the moment, the market doesn't seem to care. Stay tuned.

Is China Foreshadowing A Devaluation? BIG News, If True.

Last week, Beijing opened the door to a RMB devaluation.

The PBoC "set the midpoint rate, around which the yuan is allowed to trade in a 2% band, at 7.1004 per dollar, 62 pips weaker than the previous fix of 7.0942. The Chinese central bank has for months been setting the rate at levels firmer than market projections, traders said. The offshore yuan continued to weaken to hit a more than four-month low of 7.2525. (Reuters 3/22)

Given the slow-motion implosion of its still-massive real estate sector, it would make sense for Beijing to slash short rates toward 1%. That would pressure the RMB, as we've seen before.



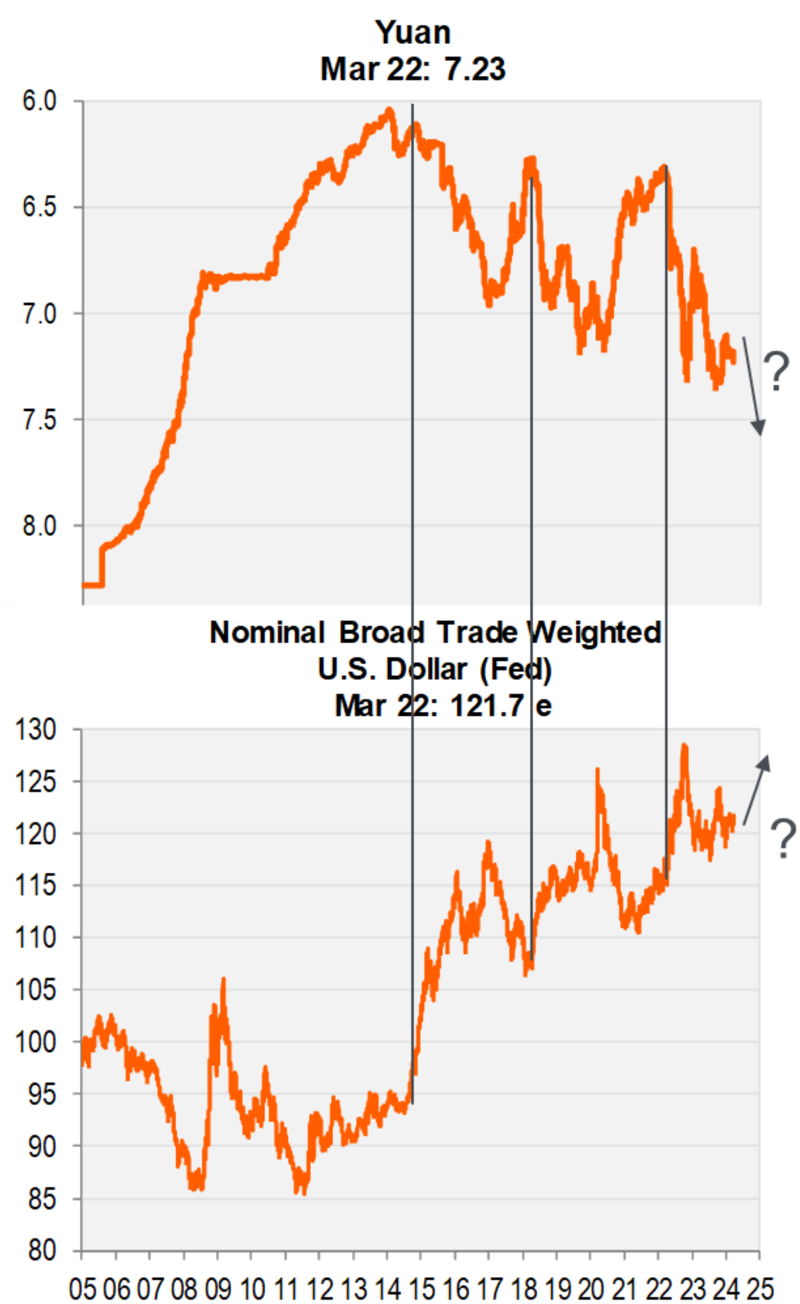
With China's wobbly economy, rate cuts and a weaker RMB may be in the Cards.

Indeed, bond yields are already at a record low … why not short rates too?

Bond yields are already at a record low. And if the PBoC doesn't cut SHIBOR soon, China could have a yield curve inversion --- the last thing Beijing needs now.

The last time Beijing devalued, in the summer of 2015, there were huge global implications:

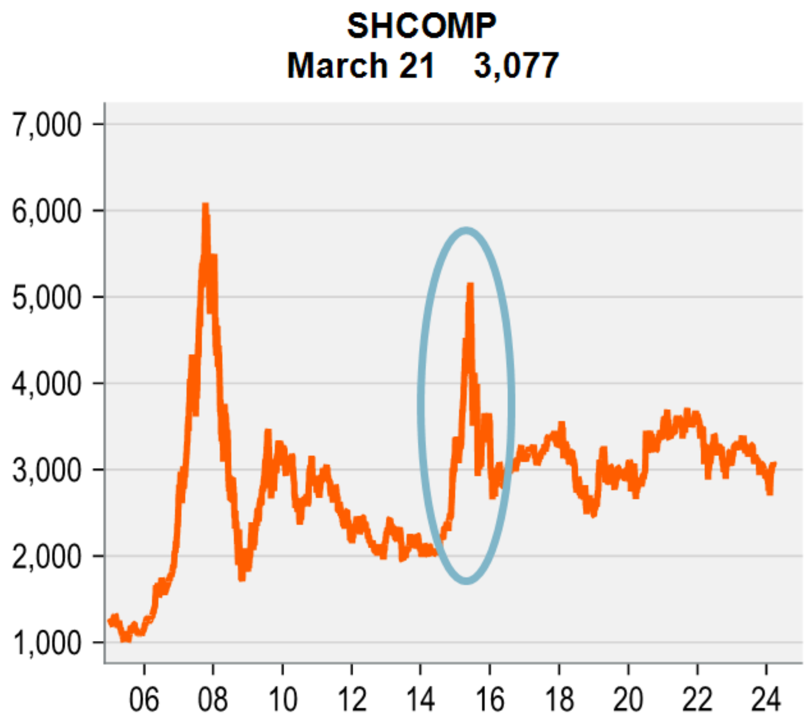
1. **The trade-weighted dollar soared. And today, the RMB is 15% of the TW$, so a big greenback rally would ensue.**



A further decline in the yuan, would most likely put significant upward pressure on the TW$, triggering a whole host of other market movements, including weaker commodity prices, weaker EM currencies, and weaker EM stocks.

2. **A surge in the TW$ would drive down other EM currencies.**
3. **EM stocks would likely way underperform.**
4. **Chinese exports would cheapen further, disadvantaging western companies.**
5. **U.S. multinational earnings would suffer from dollar strength.**
6. **Many commodity prices would soften.**

7. Chinese shares could recover, as they did in 2015.



Further PBoC easing might help, at least temporarily, boost Chinese stocks, ala 2015. That said, the rally quickly reversed.

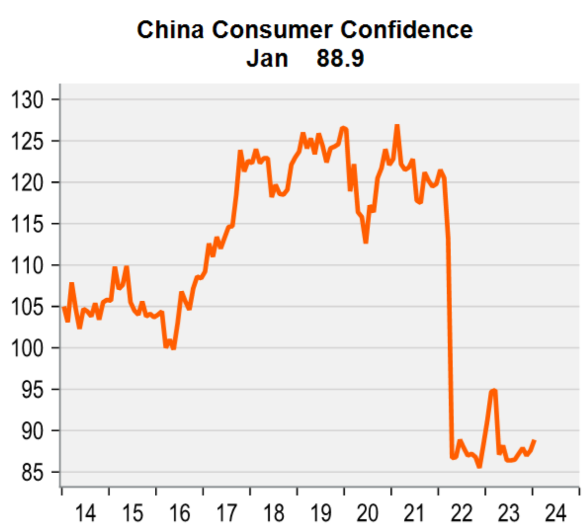
Why would China devalue? Along with other easing moves, they need to cut rates significantly given major headwinds to the economy, as listed below.

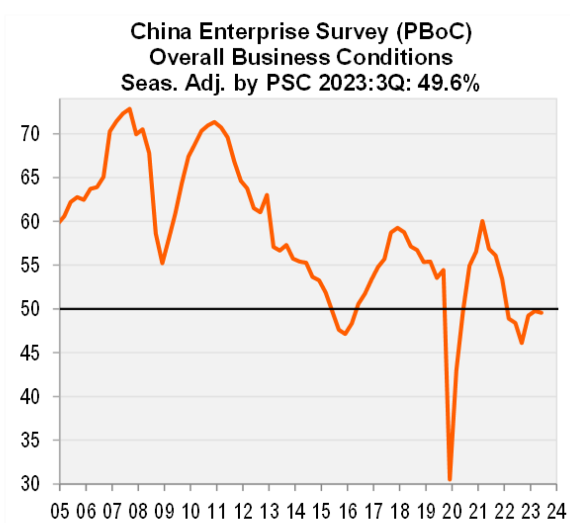
1. **The popping of their real estate bubble is a MAJOR headwind on their economy (and financial markets), as this chart highlights.**

Although there was some better China eco data last week, e.g., industrial production, the continued weakness in real estate is a severe headwind to GDP.

2. **Unemployment, and social dissatisfaction, are uncomfortably high.**
3. **Consumer and business confidence are extremely depressed, restraining activity and spending. A stock market rally might lift sentiment.**

The real estate crisis is hitting both consumer and business confidence.





4. **With no inflation problem, a weaker currency wouldn't likely trigger a surge in prices.**
5. **A weaker RMB would boost the export sector, helping counterbalance the dead weight of slumping property on domestic demand.**

We'd thought a devaluation was off the table, given Beijing's ambition to have the RMB be an international reserve currency. Perhaps domestic eco stress has changed Xi's priorities. Stay tuned.

Watch Swings In Unemployment.

First, it is NOT taking longer than normal for a Fed tightening cycle to raise the unemployment rate (as we repeatedly pound the table). It's been 24 months since Powell lifted off, and on average the Sahm recession rule gets triggered in 29 months. (Sahm rule: Recession starts after the 3 mo. avg. of the unemployment rate climbs 50bps from its cycle low.)

Recession	Month Federal Funds Rate Raised	Month Sahm Rule Was Triggered	
1960-1961	Aug 1958	Oct 1960	26
1969-1970	Nov 1967	Mar 1970	28
1980	May 1977	Jan 1980	33
1981-1982	Aug 1980	Nov 1981	15
1990-1991	Apr 1988	Oct 1990	30
2001	Feb 1999	Jun 2001	28
GFC	Jul 2004	Feb 2008	44
	Average	29 Months	

Why focus on this? Timeliness. The Sahm/unemployment signal flashes 2 months into a downturn, on average. The official NBER ruling always comes much later.

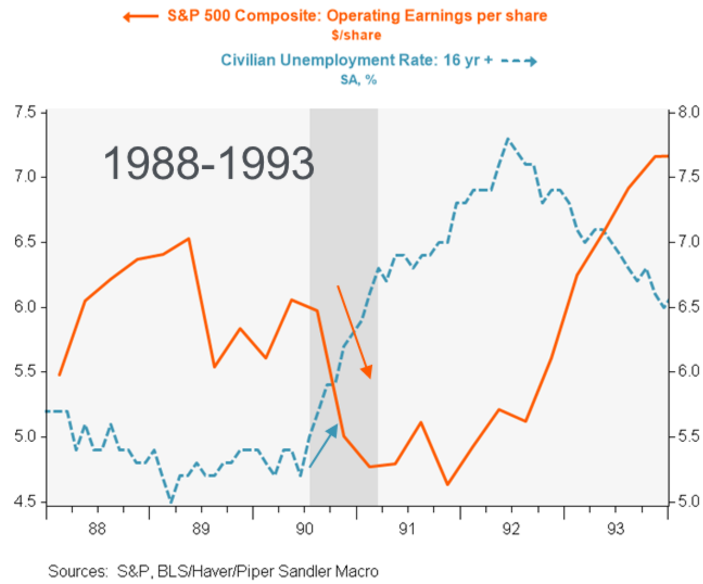
On Average, The Sahm Rule* Has Been Triggered 2 Months After A Recession Started.

Recession	Month Sahm Rule Was Triggered	Recession Start	
1960-1961	Oct 1960	May 1960	5
1969-1970	Mar 1970	Jan 1970	2
1980	Jan 1980	Mar 1980	-2
1981-1982	Nov 1981	Aug 1981	3
1990-1991	Oct 1990	Aug 1990	2
2001	Jun 2001	Apr 2001	2
GFC	Feb 2008	Jan 2008	1

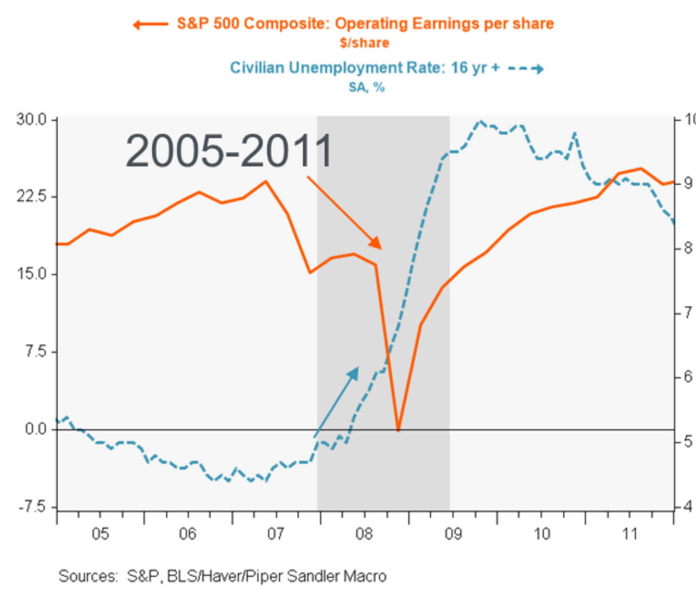
Average 2 Months

***Sahm Rule: If the unemployment rate, 3 mo. avg, increases 0.5ppts from its cycle low, there's always been a recession.**

Second, <u>a clear increase in unemployment signals a clear decline in S&P earnings</u>. See the 3 episodes below.

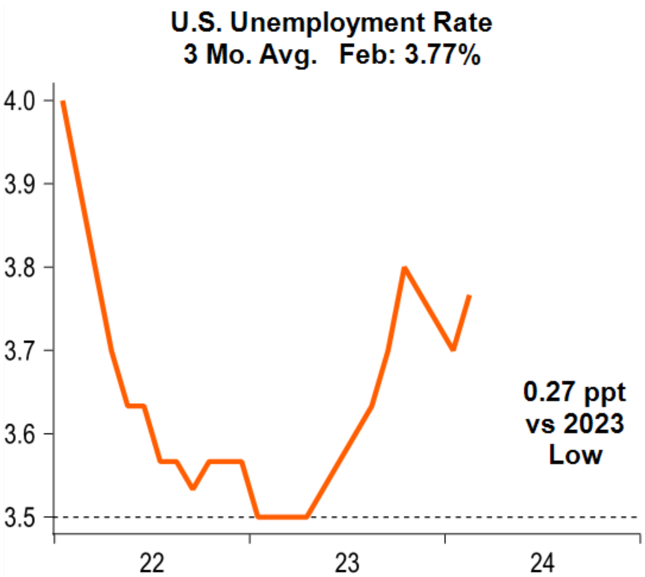


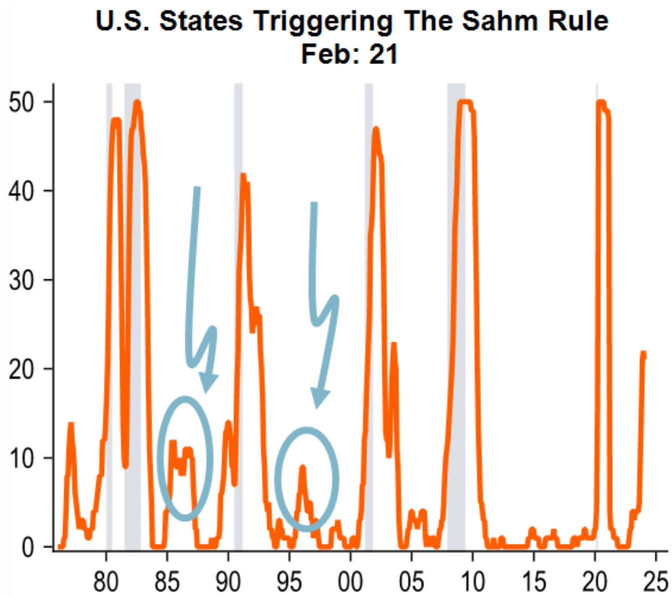
A clear increase in the unemployment rate signals a clear decline in S&P EPS. See 1990, 2001, and 2008



Nationally, the Sahm rule has NOT been triggered – its overall unemployment measure is up just 0.27ppts. But it has been triggered in 21 states, representing 45% of GDP. And there's been only one case when a 21-state Sahm signal did not signal recession -- 2003, at the tail-end of a big Fed easing cycle.

The national unemployment rate has increased just 0.27ppts on a 3 month average basis. But there have been 21 states where the Sahm rule has been triggered, which except for 2003, always signaled a recession.

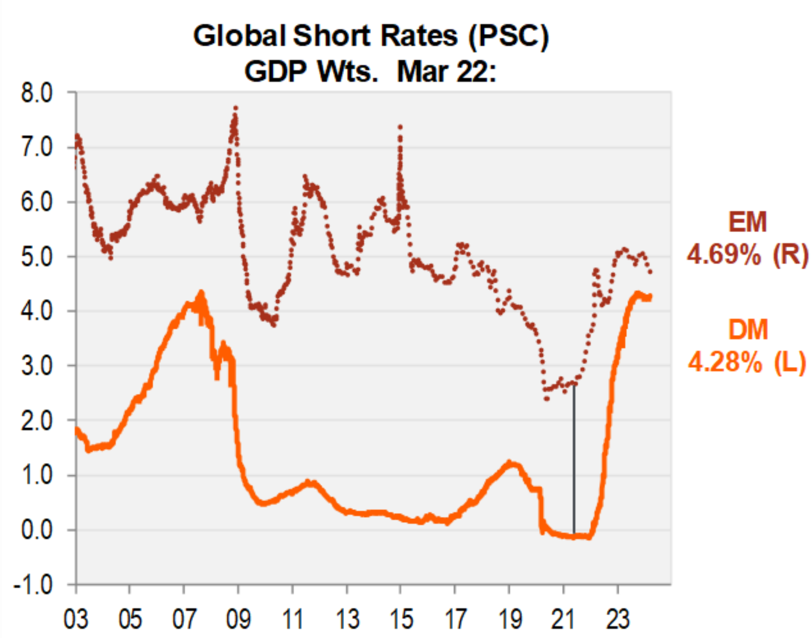




So to get a handle on the direction of earnings, watch unemployment. And as noted above, the level of nominal earnings has been basically stagnant for 2 years, with real earnings trending lower.

Here Comes The Global Easing Cycle.

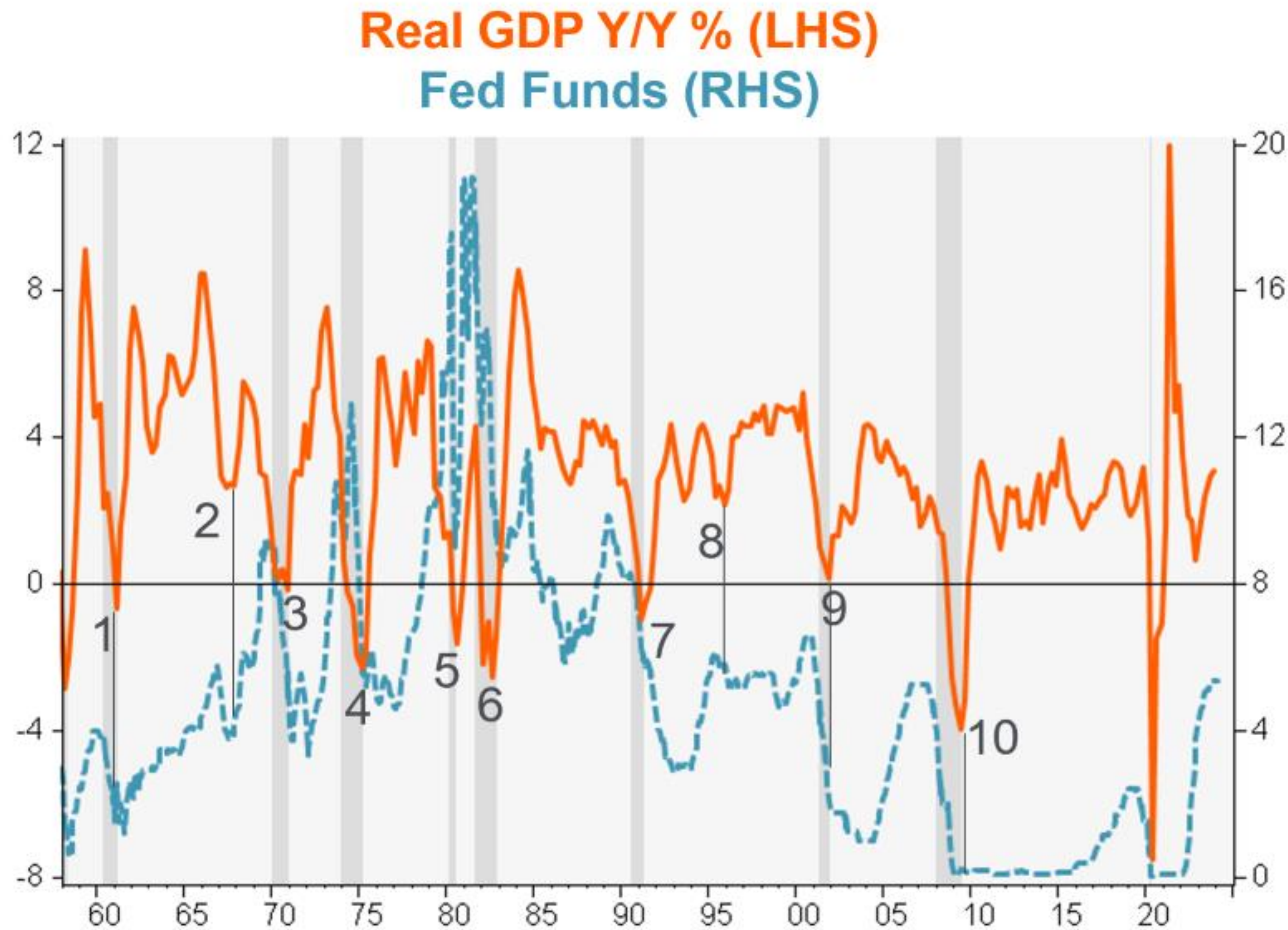
It's not just China -- other EMs are easing too, with Brazil and Mexico cutting rates last week, as their economies (and inflation) slow.



EMs led the global tightening cycle, starting in 2021. Now, they're leading the easing cycle.

As is often the case, Japan was an outlier, kicking off a tightening cycle. But elsewhere, major DMs all lean toward easing. Indeed, Switzerland just surprised markets by cutting rates. The Fed, ECB and BoE are expected to follow suit later this year.

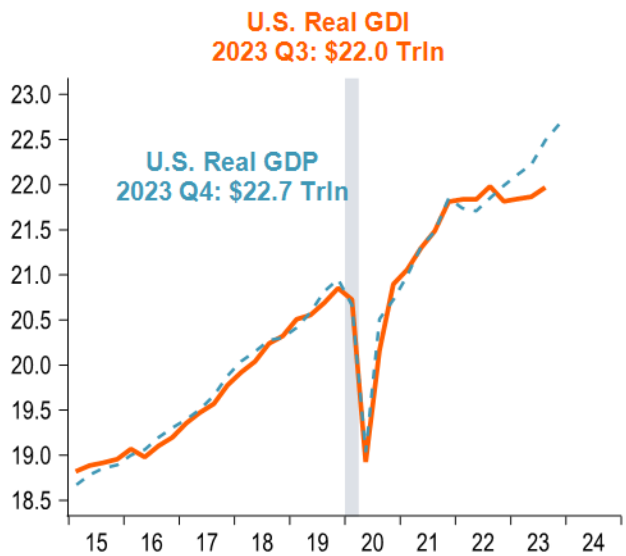
The unfolding global easing cycle will eventually be positive for Global growth. As for the U.S., a Fed pivot will be necessary for an eco reacceleration. In fact, following all 10 prior tightening cycles, activity did not pick back up until AFTER the Fed kicked off an easing cycle.



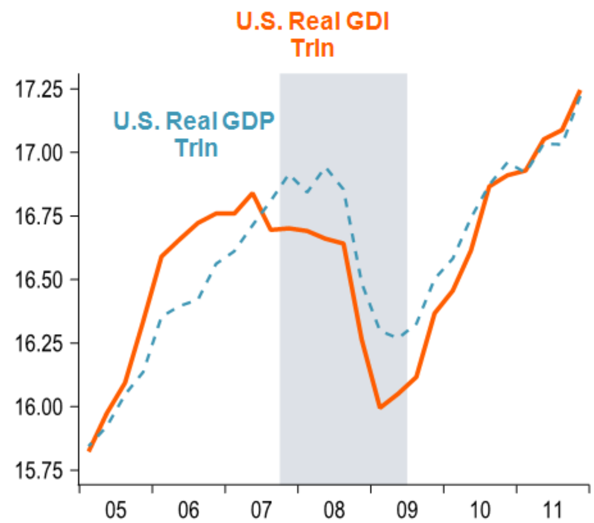
We think it <u>won't</u> be different this time. Real GDI (a cleaner measure than GDP) has been flattish for 2+ years. And it led GDP by a year going into the 2008 recession.

Although real GDP has reaccelerated, real GDI has continued to be stagnant. And real GDI led real GDP in 2007 by 1 year, i.e., it peaked in 3Q of 2007, while GDP peaked in 3Q of 2008.

2015-2024



2005-2010



Watch for 4Q real GDI this Thursday.

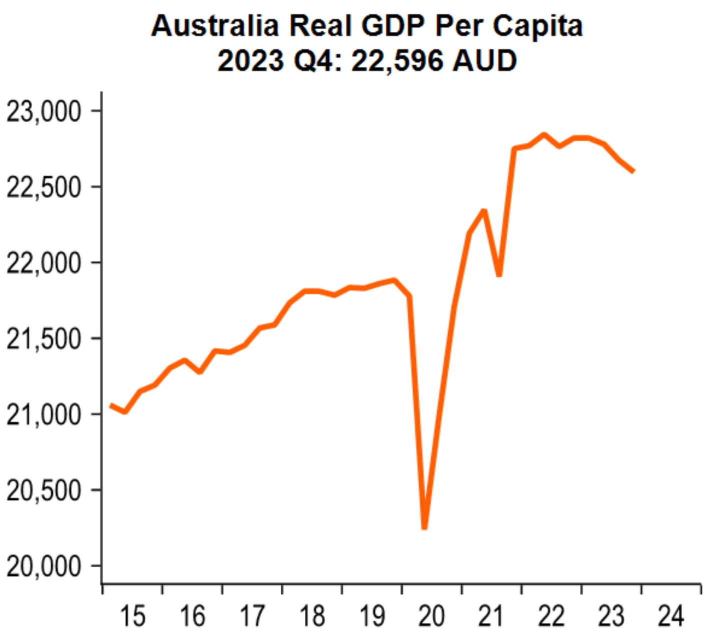
Trip Notes: From Hong Kong To Australia.

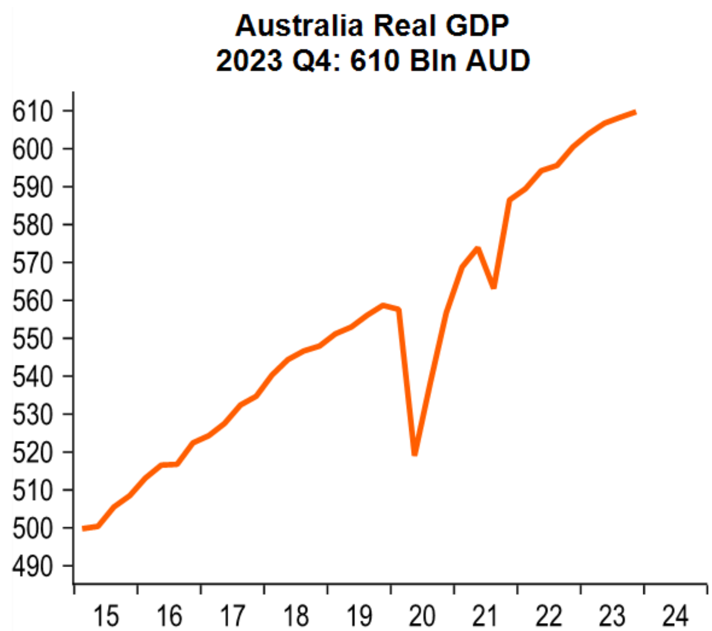
Last week, I visited institutional investors in Hong Kong and Australia. Will Wightman pulled together a GREAT trip! Investors were focused on economic themes for the stock market versus “quality”. Infrastructure, onshoring, and AI (of course) were big topics of discussion. And similar to the U.S., there was definite pushback on our recession call … not surprising, given the S&P’s near-10% rally here in 1Q.

Hong Kong looked busy, with a couple of big Wall Street conferences. But retailers were struggling, given HK$ strength (tied to the US$), vs. the weak RMB. Shoppers just cross into the mainland. We also heard concern that

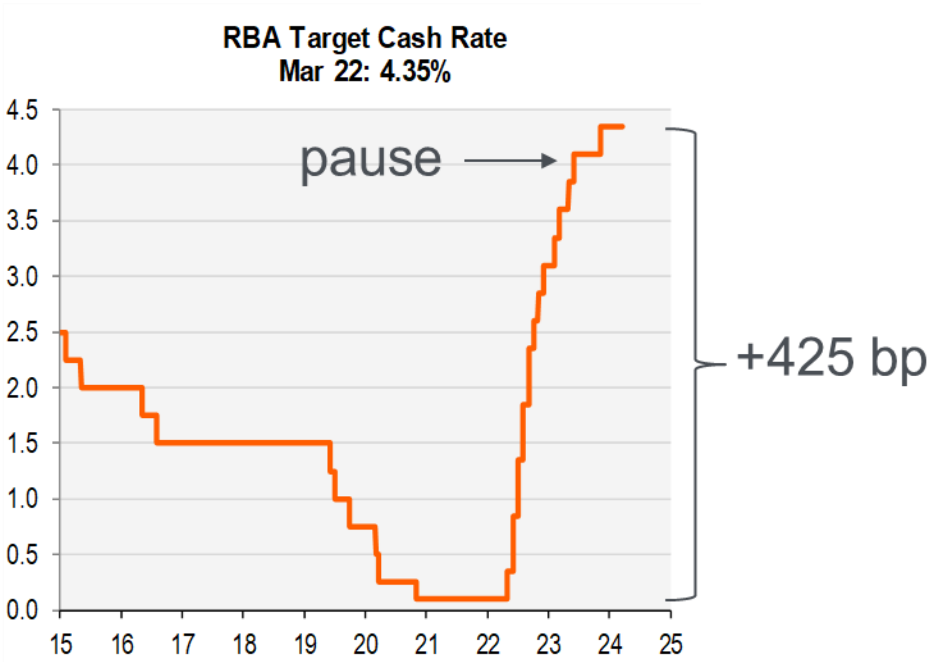
Beijing's heavy hand is squeezing HK too hard. The general view on China was that its economy is bouncing along the bottom.

I haven't visited Australia since 2016, and boy did it look prosperous. Massive immigration has created a significant housing shortage, and pulled down real per capita GDP, even though total real GDP is up.





That said, the lagged impact of the RBA's tightening cycle is expected to slow overall growth going forward.



The RBA paused their tightening cycle in early 2023, only to tighten again, as inflation remained sticky. Hmm.

And with the cost of living in Singapore having surged, more of the investment community is expected to shift to Australia. We certainly look forward to visiting HK and Australia again in the coming years!

Watching AI Closely.

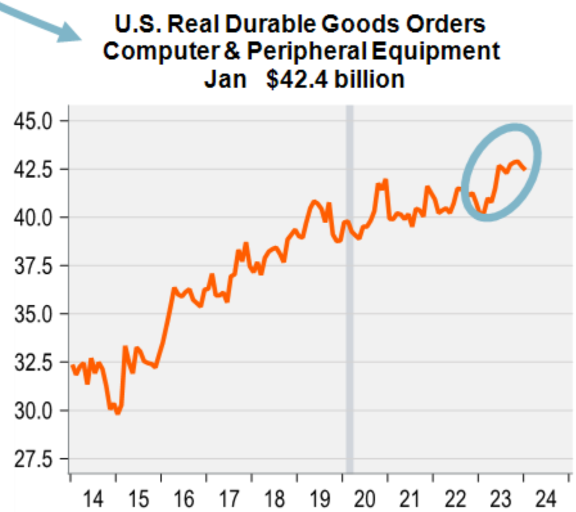
Last week saw more interesting AI news:

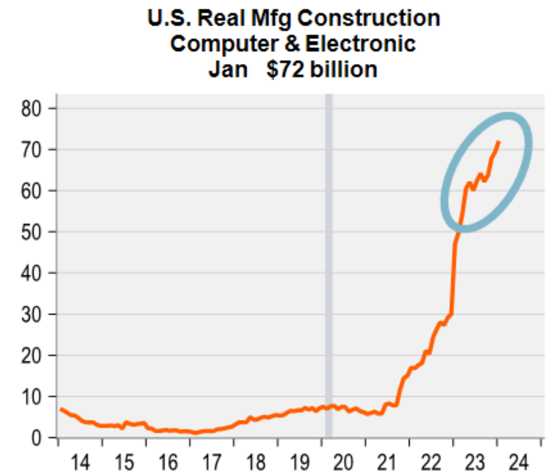
1. **Positive: Micron Technology is projecting a 76% surge in revenue for the current quarter. WSJ 3/22**
2. **Positive: Elon Musk has released the raw computer code behind his version of an artificial intelligence chatbot, an escalation by one of the world's richest men in a battle to control the future of A.I. NYT 3/19**
3. **Positive: As the market for AI models consolidates around Microsoft, Open AI and a handful of other proprietary systems and players, some companies are aiming to compete by offering their AI models free. WSJ 3/22**

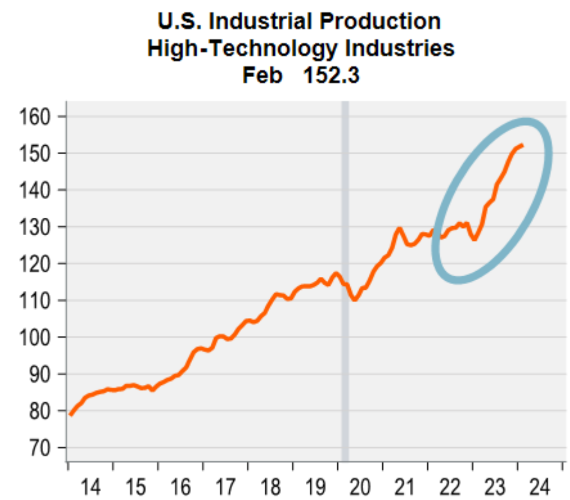
4. **Positive/Negative: The energy industry rushes to embrace AI's electric future. Energy companies increasingly cite AI as a major driver of electricity demand. But the grid could hold everything back. Barron's 3/18**
5. **Positive: The head of Japan's biggest recruitment agency says AI will resolve the country's labor shortages, but has warned that its usefulness will be limited until people gain more trust in the technology. FT 2/19**
6. **Positive/Negative: The Department of Homeland Security has seen the opportunities and risks of AI firsthand. It found a trafficking victim years later using an AI tool that conjured an image of the child a decade older. But it has also been tricked into investigations by deep fake images created by A.I. NYT 3/18**
7. **Positive/Negative: Learn to use AI at work. Your job may depend on it. WSJ 3/23.**
8. **Negative: Leading western and Chinese artificial intelligence scientists have warned that tackling risks around the powerful technology will require international co-operation similar to the cold war effort to avoid nuclear conflict. FT 3/19**

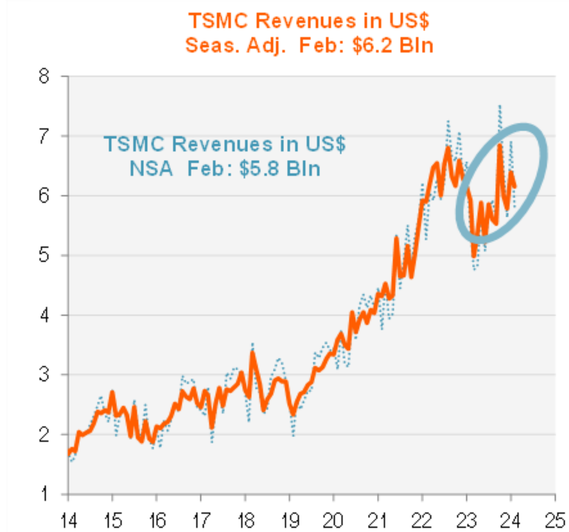
As we've highlighted, there are certain monthly economic series we can watch to see AI's direct impact on economic activity. This week, we'll get durable goods orders for February, which could show a sharp increase for computer & peripheral equipment.

We're watching these 4 eco data sets to gauge AI's direct impact on U.S. eco activity. We're expecting durable goods orders on computer & peripheral equipment to pick up sharply. Stay tuned.









Key U.S. & International Data Releases.

U.S. Data Releases

3/25 **Feb New Home Sales** are projected to climb +2.1% m/m, to 675k units.

3/25 **Mar Dallas Fed Mfg Index** is expected to tick down to -11.5, from Feb's -11.3.

3/26 **Mar Richmond Fed Mfg Index** is forecast to hold steady at -5.

3/28 **Unemployment Claims** for the week ending Mar 23rd are projected to increase 5k, to 215k, with continuing claims up +8k to 1,815k (week of Mar 16).

3/28 **Mar Chicago PMI** is expected to improve to 46.0, from Feb's 44.0.

3/29 **Feb Real Consumer Spending** is forecast to tick up +0.1% m/m, with the headline PCE deflator up +0.4% m/m (2.5% y/y, vs. 2.4%), and the core deflator up +0.3% m/m (unchanged y/y at 2.8%).

International Ex China Data Releases

3/26 **Mar prelim Brazil IPCA-15 CPI** is projected gain +0.32% m/m (vs Feb's 0.78%), and slow to 4.10% y/y (from Feb's 4.49%) – helping explain why the BCB eased -50bp to 10.75% this week – its sixth cut since Aug 2023.

3/27 **Feb Mexico Unemployment Rate** will likely slip to 2.80% (vs Mar's 2.85%) – near record lows, helping explain why Mexico's wage growth has accelerated, and why Banxico eased just -25bp this week, to a high 11.00% -- its first cut this cycle, lagging other Latam / EM central banks.

3/27 **Mar Eurozone EC Economic Sentiment Index (ESI)** is projected to gain +0.8 pts m/m to 96.2, with industrial confidence flat at -9.5, but services up +1.7 pts 7.7 – echoing the PMIs' svc-stronger-than-mfg pattern. … FYI:

The European Commission uses the ESI to track the bloc's economic activity as a whole; its harmonization and breadth of underlying country/sector detail make it a very useful comparison tool.

3/27 **Mar prelim Spain headline CPI** will likely pop +0.6% m/m (vs Feb's +0.4%), and accelerate to 3.1% y/y (from Feb's 2.8%). Mar Core is seen at 3.4% (vs Feb's 3.5%) – relatively sticky. Blame rapid wage gains?

3/28 **Mar Germany Unemployment Rate** is seen unch m/m at 5.6%, but higher than 2019's 4.9%. The recession and slowly rising unemployment are putting downward pressure on German wages, which slowed to 2.4% y/y in 4Q – quite a contrast to Spain's 5.2% y/y labor costs gains, where activity is being supported by stimulus and tourism.

3/29 **Mar prelim France headline CPI** may increase +0.5% m/m (vs Feb's +0.9%), and slow to 2.7% y/y (from Feb's 3.0%). Slower inflation is a boost for **Mar Consumer Confidence** -- out 3/27 -- and seen up 1.0 pt to 90.0, near Jan's 91.0 cycle high.

3/29 **Mar prelim Italy headline CPI** is expected to be flat m/m, growing 1.3% y/y (vs Feb's 0.8%).

March CPI estimates for the bloc's major economies are all over the place, in part driven by varying eco trajectories and the lagged impacts of stimulus. The flash CPI for overall Eurozone will be released on 4/3.

China Data Releases

3/30 **Mar CFLP mfg & non-mfg PMIs** may add clarity, given how mixed the high-frequency data have been (Yicai better, property transactions weak).

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